BEFORE THE TAX COMMISSION OF THE STATE OF IDAHO

In the Matter of the Protest of	)	
	)	DOCKET NO. 20295
[REDACTED]	)	
	)	DECISION
Taxpayer.	)	
	)	

On April 27, 2006, the Sales, Use, and Miscellaneous Tax Audit Bureau (Bureau) of the Idaho State Tax Commission (Commission) issued a Notice of Deficiency Determination to [Redacted]. The Notice proposed sales tax, penalty, and interest in the total amount of $67,850 for the period January 1, 2002, through December 31, 2005. The Taxpayer filed a timely appeal and petition for redetermination on June 28, 2006.

The Taxpayer requested an informal hearing, which was held by telephone on August 7, 2007. Based on that hearing, the material in the audit file, a review of the applicable Idaho sales tax statutes, and relevant federal case law, the Commission herein upholds the Notice of Deficiency Determination for the following reasons.

Background

[Redacted]. [Redacted].

The Multistate Tax Commission (MTC) conducted a sales and use tax audit of the Taxpayer's business at its U.S. headquarters on behalf of Idaho's State Tax Commission. The MTC Audit Program operates under authority of the Multistate Tax Compact, and MTC auditors are agents of states when conducting audits at the direction of the states. Each state is responsible for making assessments after the MTC issues recommendations.

The MTC did not find any sales tax liability for the state of Idaho. However, the MTC did not believe it received a complete accounting of the Taxpayer's sales. More importantly, the MTC noted that the Taxpayer declined to fill out a customary nexus questionnaire that would have

provided information on the Taxpayer's contacts with the state including the frequency of visits by the Taxpayer's employees (or agents) and the nature of those visits.

For reasons that will be detailed, the Commission believes that the State of Idaho has the authority to require the Taxpayer to collect tax on Idaho sales that are not exempt. Using records from a third-party and indirect audit methods, it determined a liability and issued a Notice of Deficiency Determination, which the Taxpayer timely protested on the grounds that it did not have a sufficient presence in Idaho to require it to collect sales tax. Aside from that premise, the Taxpayer argued that it had a document from its sole Idaho-based customer that held the Taxpayer harmless for any tax due on sales to that customer. Further, it questioned the methodology used by the Commission in arriving at the deficiency amount.

[Redacted]. No tax is due on these sales, and they are therefore not the subject of this decision. The sole matter is whether the Taxpayer should have collected tax on the sale of product advertising, corporate literature, mechanic training materials and the like, [Redacted].

Applicable Statutes

Idaho imposes a tax on the sale of tangible personal property in this state.

> **Sale. --** (1) The term "sale" means any transfer of title, exchange or barter, conditional or otherwise, of tangible personal property for a consideration and shall include any similar transfer of possession found by the state tax commission to be in lieu of, or equivalent to, a transfer of title, exchange or barter (Idaho Code §63-3612).

[Redacted]. Such sales are excluded from the definition of "sale at retail" and are therefore not taxable (Idaho Code § 63-3609). For all sales subject to tax, however, the tax must be collected by the retailer from the customer (Idaho Code § 63-3619(b)). In order for a collection responsibility to be imposed, however, the retailer must be "engaged in business" in Idaho, as defined below:

> **Retailer engaged in business in this state**. "Retailer engaged in business in this state" as used in this chapter means any retailer who:

> (1) Engages in recurring solicitation of purchases from residents of this state or otherwise purposefully directs its business activities at residents of this state; and
> (2) Has sufficient contact with this state, in accordance with the constitution of the United States, to allow the state to require the seller to collect and remit use tax on sales of tangible personal property or services made to customers in this state.
> (3) The term includes any of the following:
> (a) Any retailer maintaining, occupying or using, permanently or temporarily, directly or indirectly, or through a subsidiary or agent, by whatever name called, an office, place of distribution, sales or sample room or place, warehouse or storage place, or other place of business or maintaining a stock of goods.
> (b) Any retailer having any representative, agent, salesman, canvasser or solicitor operating in this state under the authority of the retailer or its subsidiary for the purpose of selling, delivering, installing or the taking of orders for any tangible personal property.
> (c) Any retailer, with respect to a lease or rental, deriving rentals from a lease or rental of tangible personal property situated in this state.
> (d) Any retailer engaging in any activity in connection with servicing or installing tangible personal property in this state.
> (e) Any retailer owned or controlled by the same interests which own or control any retailer engaged in business in the same or a similar line of business in this state.
> (f) Any retailer having a franchisee or licensee operating under its trade name if the franchisee or licensee is required to collect the tax under the provisions of this section (Idaho Code § 63-3611).

The Taxpayer claims in its protest letter and during the hearing that it is under no obligation to collect Idaho's sales tax:

> [Redacted]

Analysis

The Commission agrees with the Taxpayer that for a retailer to be required to collect tax on sales depends upon the retailer having a sufficient physical presence in the taxing state and that this is a U.S. Constitution-based consideration.

Subsections (1) and (2) of Idaho Code § 63-3611 were added in 1998, (See, 1998 Idaho Session Laws, Chapter 49), about six years after *Quill Corporation v. North Dakota,* 504 U.S. 298,

(1992), and state the Constitutional standard articulated by that U.S. Supreme Court case. Subsection (3) sets out specific activities included within the statutory definition. One activity of significance to the Commission's argument is:

> Any retailer owned or controlled by the same interests who own or control any retailer engaged in business in the same or a similar line of business in this state (Idaho Code § 63-3611(3)(e)).

The Taxpayer has wholly-owned subsidiaries [Redacted]. The [Redacted] subsidiary has undisputed physical presence in the state including an office and employees. In Idaho, the lease or rental of tangible personal property is a retail sale subject to tax (Idaho Code § 63-3612(2)(h)). The Taxpayer's [Redacted] entity is registered to collect taxes and does so.

The Idaho Legislature was cognizant that the language of Idaho Code § 63-3611, subsection (3) should not attempt to impose a collection duty not justified by subsections (1) or (2). This understanding of subsection (3) comports with the Legislature's "Statement of Purpose" that accompanied the 1998 amendment:

> [T]he bill adds language to insure that the Act reaches the full extent of Idaho's constitutional power to require out-of-state sellers to obtain an Idaho sales tax permit and to collect and remit Idaho sales or use tax.

Although the Commission is uncertain about control *per se*, we do know that the parent Taxpayer owns the [Redacted] entity and that both are engaged in similar activities. [Redacted]. The purpose of and the bond among the Taxpayer and two of its subsidiaries is articulated on the parent's web site.

> [Redacted]

[Redacted]. According to an e-mail exchange between the Commission and an employee [Redacted], [Redacted]. [Redacted].

The Commission believes that it has met the burden of proving that the Taxpayer qualifies as a "retailer engaged in business in this state" as outlined previously in the three sections of Idaho Code § 63-3611. The Taxpayer "purposefully directs its business activities [Redacted] of this state" (Section (1)); "[h]as sufficient contact with this state" (Section (2)); and is a "retailer owned or controlled by the same interests which own or control any retailer engaged in business in the same or a similar line of business in this state" (Section (3)(e)). As an Executive Branch agency, the Commission will not declare this unambiguous statute inapplicable on constitutional grounds.

The above notwithstanding, this decision will review case law to show that no precedent set by the U.S. Supreme Court is disregarded or breached by the Idaho statutes relied upon herein.

Is the Taxpayer physically present in Idaho for the purpose of collecting sales tax? The U. S. Supreme Court ruled in *Quill* that a business must be physically present in a state before that state can require the business to collect sales or use tax.

[Redacted]. [Redacted].

Quill left a significant question unanswered. Specifically, does the presence of a retailer in Idaho create nexus for a separately incorporated parent company? In *Complete Auto Transit, Inc. v. Brady*, 430 U.S., at 285, 97 S.Ct., at 1082 (1977), the Court adopted a four-part test to determine if a state could impose a tax on activities involving interstate commerce. It is permissible for a state to impose a tax affecting interstate commerce as long as the "tax [1] is applied to an activity with a substantial nexus with the taxing State, [2] is fairly apportioned, [3] does not discriminate against interstate commerce, and [4] is fairly related to the services provided by the State." (430 U.S., at 279, 97 S.Ct., at 1079).

In deciding both *National Bellas Hess Inc. v. Department of Revenue of Ill.*, 386 U.S. 753 (1967), and *Quill*, the court focused on the first part of this test requiring there be activities with a

"substantial nexus" with the taxing state. These cases are generally understood to mean, in the context of imposition of a sales or use tax collection obligation, substantial nexus requires that there must be some physical presence within the taxing state by the seller. However, activities of other legal entities may be attributed to the seller to meet the physical presence requirement. For example, in *Scripto Inc. v. Carson*, 362 U.S. 207, 80 S.Ct. 619 (1960), the court held that it was not necessary for a business to have employees present in a state. Nexus could be created by independent sales representatives working for the business. The court reached a similar result in *Tyler Pipe Industries v. Washington Dept. of Revenue*, 483 U.S. 232 (1987). More recently, although not a U.S. Supreme Court decision, the California Court of Appeals attributed the activities of an in-state affiliate to an out-of-state remote seller to find the necessary physical presence to create the required substantial nexus of the out-of-state affiliate. See, *Borders Online LLC v. California State Board of Equalization*, 129 Cal.App.4th 1179, 29 Cal.Rptr.3d 176 (2005). The presence of Borders' retail stores in California provided sufficient nexus for California to require Borders' online subsidiary to collect tax. In *Borders*, the court noted that the retail stores would give refunds for goods purchased online. The court also noted that Borders and its online subsidiary engaged in numerous other cross-promotional activities.

What these cases have in common is that in each instance the person or affiliate present in the state conducted activities "on behalf of the taxpayer [that] are significantly associated with the taxpayer's ability to establish and maintain a market in [the] state for the sales." *Tyler Pipe*, at p. 250. This is precisely relevant to the current case. [Redacted].

[Redacted]

As noted previously, [Redacted] has an Idaho seller's permit and actively collects and remits sales tax. Sales tax return records that are immediately available show monthly activity since 1997 and a 1991 business start date.

Returning to Idaho's controlling statute (Idaho Code § 63-3611) and applying the Constitutional standards, the language in subsection (3)(e) of the statute including within the definition of "a retailer engaged in business in this state," "[a]ny retailer owned or controlled by the same interests who own or control any retailer engaged in business in the same or a similar line of business in this state" must be understood to mean that the second retailer referred to in the statute is a retailer who conducts activities "on behalf of" the first retailer and that the activities are significantly associated with the first retailer's ability to establish and maintain a market in the state for the sales. Moreover, the nexus created by this activity attributed to a retailer must be sufficient to be a "substantial nexus." Something more than a slight presence is required. See, *National Geographic Soc. v. California Bd. of Equalization*, 430 U.S. 551, (1977). However, under *National Geographic*, it is not necessary that the activities of the business in the state that create the substantial nexus be related to the sales that are being taxed, although they are arguably so in the present case.

As an alternative defense, the Taxpayer argues that its activities conducted in Idaho do not rise to the level of "transacting business in the state" as defined by Idaho Code § 30-1-1501. This statute prohibits a foreign corporation from transacting business in this state until it obtains a certificate of authority from Idaho's Secretary of State. The statute lists activities that do not constitute transacting business in the state within the meaning of the statute. It is not a nexus threshold test for sales tax. *Quill* is the test.

Coincidentally, the Taxpayer has registered with Idaho's Secretary of State since the company took its present corporate form in 1986. The Taxpayer's two wholly-owned subsidiaries, [Redacted], are registered as well. Idaho's Secretary of State website has these public records.

In another alternative defense, the Taxpayer mentions that it has a valid resale certificate from its sole customer in Idaho. The Taxpayer is proposing, *arguendo*, that if it was in fact an Idaho-registered seller with responsibility for collecting taxes on sales, it would be relieved of that responsibility because it has a valid exemption certificate from the buyer.

In order to be valid, all forms must comply with any requirements provided in Rule 128 (Certificates for Resale and other Exemption Claims) or on the form in question. (IDAPA 35.01.02.128.05.) The Commission has not seen a copy of the form the Taxpayer refers to but presumes it to be the Commission's form ST-101, Sales Tax Resale or Exemption Certificate. A reseller of goods, [Redacted], will present this form to a seller in order to buy resale inventory exempt from tax. In order to be valid, the buyer must enter a description of those products that it intends to resell in the course of business. Again, presuming the certificate was filled out properly by the buyer, the description would indicate "[Redacted]" or similar language. Hence, the exemption would be valid for the purchase of those items but not for the others that are at issue in this decision: advertising, promotional literature, and training materials. The Commission requested a copy of the certificate from the Taxpayer but did not receive one. The burden is upon the seller to show documentation that it made a valid tax-exempt sale to the buyer. [Redacted]. [Redacted].

The Taxpayer objects to the method by which the Commission arrived at a liability amount. The Commission did not have access to the sales documents for the period under audit, nor did the MTC auditor have complete information, based on its audit record. Auditors in the Bureau had access to the Taxpayer's sole customer's records for a particular period of time, and it created a liability based on them. In order to appreciate the validity of this indirect audit estimate, we must discuss the subject of use tax.

All states that impose sales tax also impose a complementary use tax. Use tax (at a rate identical to sales tax) is due from a buyer and is paid directly to the state when a buyer has not or cannot pay sales tax to the seller. The Commission's Bureau's audit staff confirmed that for the period of the Taxpayer's audit conducted by the MTC, the Taxpayer's sole customer did not accrue use tax o[Redacted]. Using records at hand from another time period and treating them as a reasonable proxy for the period under audit, the Bureau devised a rational estimate of liability. The Bureau gave the Taxpayer an opportunity to provide actual records from the time period under audit. It did not respond to this request presumably due to its disagreement over the Bureau's underlying presumption of liability.

The Bureau made adjustments to the deficiency in the Taxpayer's favor to account for additional use tax accrued by the Taxpayer's customer. The Commission agrees that the adjustment is valid. The Bureau added interest and penalty to the deficiency per Idaho Code sections 63-3045 and 63-3046. Interest continues to accrue on unpaid tax liability and has been updated to April 21, 2008.

WHEREFORE, the Notice of Deficiency Determination dated April 27, 2006, is hereby ADJUSTED and, as ADJUSTED, is APPROVED, AFFIRMED, and MADE FINAL.

IT IS ORDERED and THIS DOES ORDER that the taxpayer pay the following tax, penalty, and interest:

TAX	PENALTY	INTEREST	TOTAL
$ 36,723	$ 9,181	$ 10,598	$ 56,502

DEMAND for immediate payment is hereby made and given.

An explanation of the taxpayer's right to appeal this decision is enclosed with this decision.

DATED this_____day of _____, 2008.

IDAHO STATE TAX COMMISSION

_____
COMMISSIONER

CERTIFICATE OF SERVICE

I hereby certify that on this _____ day of _____, 2008, a copy of the within and foregoing DECISION was served by sending the same by United States mail, postage prepaid, in an envelope addressed to:

[REDACTED] Receipt No.

_____